Winspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

BelAir

ENERGY CORPORATION

1998 Annual Report

AR59

Corporate Profile

BelAir Energy Corporation is an emerging oil and gas company headquartered in Calgary, Alberta and is publicly listed on The Alberta Stock Exchange under the symbol "BGY". Incorporated in 1996, BelAir's growth has been based on strategic acquisitions and low risk development.

Annual General Meeting

The Annual General Meeting of Shareholders will be held on Wednesday, May 5, 1999 at 3:00 pm, in the Northcote/Angus Room, Third Floor, Bow Valley Square II, 205 - 5th Avenue, S.W., Calgary, Alberta.

Abbreviations

bbls	Barrels
Mbbls	Thousands of barrels
boe	Barrels of oil equivalent
Mboe	Thousands of barrels of oil equivalent
boepd	Barrels of oil equivalent per day
bpd	Barrels of oil or NGLs per day
Mmcfpd	Million cubic feet per day
Bcf	Billion cubic feet
NGLs	Natural gas liquids

Natural gas is equated to oil on the basis of 10Mcf = 1 boe

President's Message

1998 was an extremely active and successful year for BelAir. While the industry was weathering through one of the longest oil price downturns in history, we completed our first calendar year of operations highlighted by many accomplishments:

January Achieved a production rate of 500 boepd, a target we had set just six months earlier when we became listed on the Alberta Stock Exchange as a Junior Capital Pool company.

August Negotiated and announced a business combination with Granger Energy Corp.

September Negotiated an arrangement whereby Granger Energy Inc. would acquire production, reserves and undeveloped lands from Richland Petroleum Corporation.

October Completed the plan of arrangement amalgamation with Granger Energy Corp. With the merger, BelAir's production reached 860 boepd and undeveloped lands totalled over 100,000 net acres.

December Production for the month averaged over 1,000 boepd, well above our target of 800 boepd set at the beginning of the year in our 1997 Annual Report.

Wayne Wilson
Vice President
Corporate Development

Vic Luhowy
President and
Chief Executive Officer

Ken MacRitchie
Vice President, Finance
Chief Financial Officer

The independent engineering firm of Martin & Brusset Associates evaluated BelAir's reserves. Despite low oil prices, the evaluation indicated that BelAir had almost tripled its proven reserves over the course of the year.

Based on the net reserves added and the capital expenditures made during the year, BelAir's "all-in" finding and development costs equaled $6.00 per barrel of oil equivalent.

In addition to experiencing a very successful year as outlined above, we have also positioned our Company for solid growth into the future.

Large Undeveloped Land Position

One of the attractions of the Granger business combination last year was the addition of a large undeveloped acreage position. With over 200,000 gross acres (100,000 net acres) of undeveloped land, BelAir now has one of the larger land positions compared to our peers in the industry. The acquisition of these lands included 950 kilometres of 2D seismic and 55 square kilometres of 3D seismic. The addition of these undeveloped lands and the seismic data has positioned BelAir for strong growth into the future.

During the first quarter of 1999, our contract technical team consisting of Dave Bardwell (senior geologist), Marlo Baydala (senior geophysicist), Steve Balog and Ken Skea (senior engineers) and James Long (senior landman) plus support technical staff, has been reviewing these lands and the seismic data. The contract technical team has generated many development and exploratory prospects on these undeveloped lands. In today's environment, however, raising equity capital to finance these prospects is very difficult. Therefore, we will only exploit the low risk, low cost, quick cash flow prospects during 1999. With low oil prices and strong gas prices, we will be focusing on gas projects. Exploratory and oil prospects will be "inventoried" for times of higher oil prices and ability to raise capital.

Contract Technical Team

L to R – **Barb Steele** *(Geological Technician)*, **Steve Balog** *(Senior Engineer)*, **Wayne Brown** *(Geologist)*, **Ken Skea** *(Senior Engineer)*, **Marlo Baydala** *(Senior Geophysicist)*,**Dave Bardwell** *(Senior Geologist)*, **James Long** *(Senior Landman)*

Capital Expenditures during 1999

We manage our business at BelAir using some pretty simple, basic and prudent business principles. One of these is: "Do not allow your debt level to get higher than one and one-half times forward cash flow". During these times when it is difficult to raise capital, our capital expenditures will be limited to cash flow and the use of prudent debt financing. We may not be able to grow as quickly as our land position and prospects would allow; however, we are very well positioned when the environment improves.

Based on our projected cash flow and balance sheet, we anticipate the level of 1999 capital expenditures will be in the range of $3 to $4 million.

Oil Price Environment

BelAir's current production consists of one-third gas and two-thirds light oil. By the end of 1999, we expect our production to be 45% gas and 55% oil. We maintain, however, a bullish perspective on oil.

The oil industry is not sustainable at oil price levels in the $11 to $13 US WTI range. As a result of these low prices, capital spending has been severely cutback and there has been a substantial decrease in rig utilization. In previous periods of such capital cutbacks, production from non-OPEC countries has declined dramatically. We are seeing evidence of that decline occurring today. In the meantime, hydrocarbon demand continues to grow, perhaps not at a pace experienced during the mid-1990's, but still growing. Unlike other types of industries, such as manufacturing, production from oil and gas reserves declines from the date of initial capitalization and production. Oil producers must continually spend additional capital to find new reserves and to develop new production just to stay even. With fewer reserves and therefore less production being developed, with demand continuing to grow and with production continually declining from existing reserves, it will not take long to eliminate the 2% excess of supply over demand that we experienced during 1998. The recent announcement during March by OPEC to further reduce oil production only serves to speed up this process.

With these fundamental issues at play throughout the world, we are maintaining a bullish attitude toward oil prices in the near future.

Addition to Our Management Team

During 1999, we plan to add a fourth executive to our team. With our substantial production base and land position, our goals for 1999 include optimizing production, reducing operating costs and consolidating our land holdings. To accomplish these goals, we intend to add a Vice President, Operations to our management team.

Support of our Shareholders

During this period of depressed oil prices, we thank all of our shareholders for your understanding of our business, your patience and your continued support. From our Board of Directors, to whom we continually turn for guidance and governance, to our initial investors and our newest shareholders, we thank you and look forward to creating value for you. In addition, we welcome all the previous shareholders of Granger Energy Corp. – together we will build a dynamic junior oil and gas company.

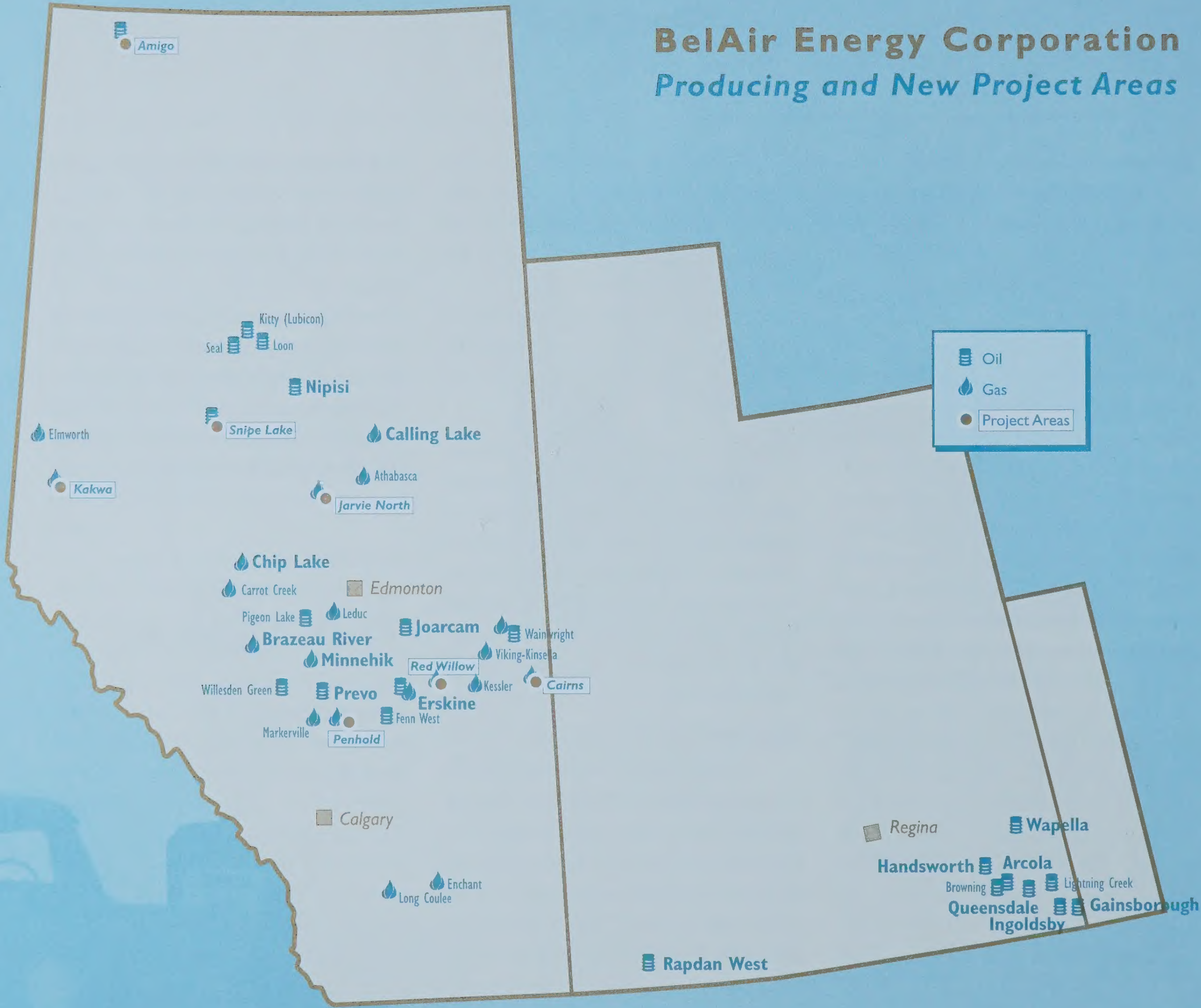
Finally, we thank Mr. Don Burns who will not be standing for re-election as a member of our Board at our 1999 Annual General Meeting. Don was instrumental in the smooth amalgamation of Windstar Energy Limited and BelAir in the fall of 1997. We thank him for his service and guidance.

Victor Luhowy

Victor M. Luhowy
President and Chief Executive Officer
March 19, 1999

BelAir Energy Corporation

Producing and New Project Areas



Project Areas

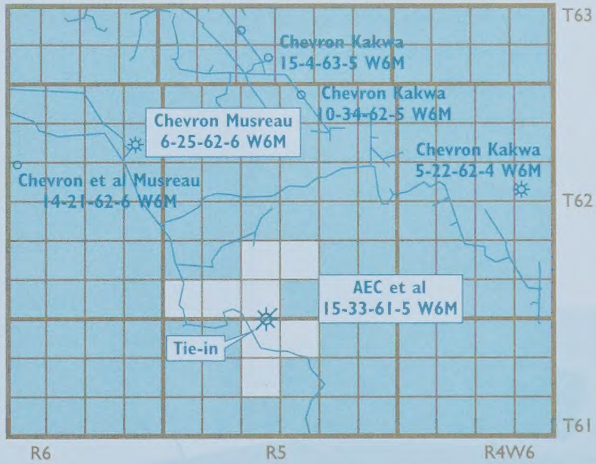
Northwest Alberta

Kakwa

BelAir participated with Alberta Energy Company in the drilling of AEC et al Kakwa 15-33-61-5 W6M during the last quarter of 1998. The well encountered 175 feet of Wabamun pay and is presently being completed.

The Kakwa well is similar to the Chevron et al Musreau discovery well 6-25-62-6 W6M drilled in 1997. Located six miles northwest of the 15-33 Kakwa well, Chevron's 6-25 well is producing 20 mmcfpd and has produced over 5 billion cubic feet of sweet gas since September, 1997.

BelAir's working interest in the subject well and seven contiguous sections surrounding the well is 5% - an appropriate participation for a company of BelAir's size in this expensive, high risk, yet high reward prospect. After completing and testing the well, AEC is planning to construct a flowline to connect the well into an existing ANG gathering system. This system is capacity-constrained and will allow us to test the well at low production levels of 3 mmcfpd. Following appropriate testing at these lower levels, a high capacity looping will allow the well to be produced at higher production rates during the latter part of 1999. Following the determination of pool reserves size, additional wells may be drilled on the jointly owned lands.



East Central Alberta

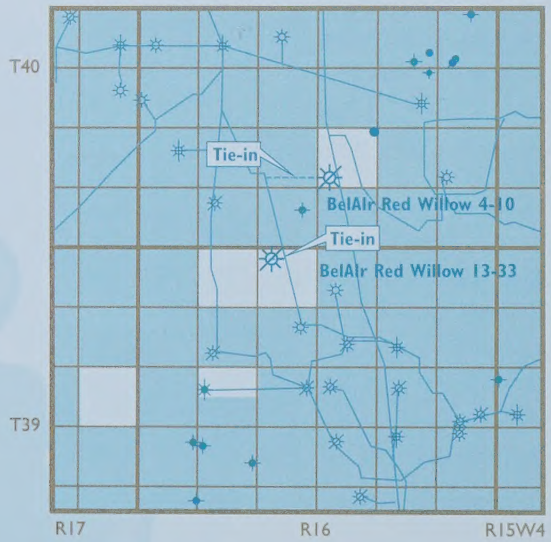
Red Willow

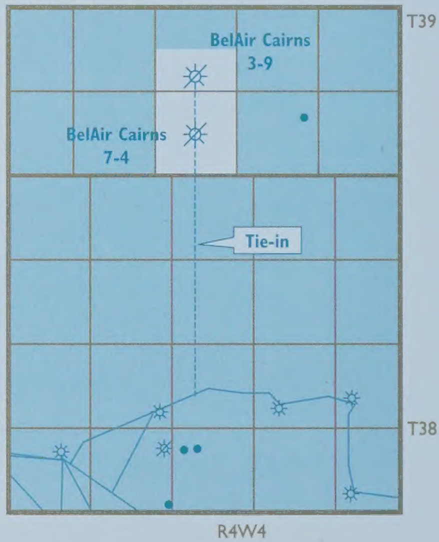
In east central Alberta, BelAir is operating a number of new gas projects. At Red Willow, a capped gas well in which BelAir has a 95% working interest, has been completed, stimulated and flow tested at 750 mcfpd. The 13-33 well has been tied into a low pressure gas gathering system and placed on production without having to install compression.

BelAir also has a 60% working interest in another capped gas well in Red Willow. The 4-10 well has been completed, stimulated and flow tested at 850 mcfpd. It will also be connected to a low pressure gathering system. BelAir has acquired lands offsetting these wells and will also be targeting the acquisition of other capped gas wells in the area.

Cairns

At Cairns, BelAir has completed, stimulated and tested a capped gas well. The well flow tested at a rate of 1,000 mcfpd. The well will be tied into a low pressure gathering system. A second well will also be completed, stimulated and tied-in if production from the first well establishes sufficient reserves. BelAir has a 70% working interest in these wells.

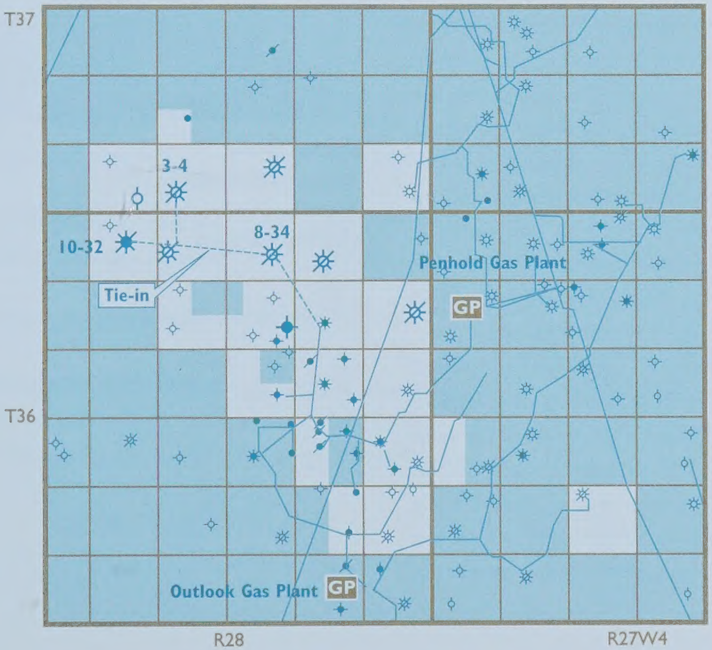




Central Alberta

Penhold

Late in 1998, BelAir acquired various working interests and operatorship in a number of shut in gas wells in the Penhold area. A processing agreement has been executed and a gathering system is being constructed to tie in three wells to the Outlook gas plant. Production from these three wells is expected to be 500 to 750 mcfpd net to BelAir. Additional wells will be tied in at a later date.



Northwestern Alberta

Amigo

Recomplete a 6 bopd well for greater production; BelAir's working interest is 75%.

Northern Alberta

Snipe Lake

Complete, test and tie-in capped gas well; BelAir's working interest is 100%.

Jarvie North

Tie-in a gas well that tested 1,400 mcfpd. BelAir's working interest is 25%.

Southeast Saskatchewan

BelAir has prospects to drill eight infill or step out oil wells and one exploration well. BelAir's working interest ranges up to 100%.

Unless acreage is expiring, oil drilling projects will be shelved until oil prices improve.

Operations

BelAir's Operating Philosophy

BelAir's operating philosophy is to employ a small core group of motivated individuals to create wealth for our shareholders and to contract-in services as they are required. We maintain a continuous relationship with a group of contractors that provide services to us on a part time basis. Sandy Babush provides us with financial accounting services. Shainy Vasanji and Deanna King fulfill our land administration requirements while Goretti Yaworski markets our oil and gas production. Because of our size, we do not require these particular services on a continuous basis. Contracting-in these services on a part-time basis is an effective method to operate an oil and gas company while minimizing general and administrative expenses.

Field Operations

The success of an oil and gas operation is based on the dedication and the relationship of a number of disciplines. One such discipline is field operations. The success of BelAir's field operations results from the dedication and experience of our "roving" contract Field Superintendent, Gordon Bosley. Gordon lives in the small village of Cherry Grove near Cold Lake, Alberta. As supervisor of all of BelAir's field operations, he is kept on the road overseeing our oil and gas operations from the south eastern corner of Saskatchewan to the north western corner of Alberta.

From the time that we obtained our first operated production in 1997, Gordon has been instrumental in ensuring that our assets are operated efficiently and at optimum rates. In addition, he has implemented many of our capital programs such as bringing on stream new production from four newly drilled oil wells at Joarcam, bringing on new production at Amigo and Erskine and constructing new gas gathering systems at Penhold and at Red Willow to bring on new gas production.

Gordon's vast experience and practical knowledge of field operations has enabled BelAir to take on the role of operator of many of its assets. With the expansion of our capital program to exploit the prospects on our undeveloped lands, BelAir is well equipped to take on the role of operator of these projects.

Gordon Bosley
Contract Field Superintendent
Over 37 years of management experience in oil field operations

1998 Highlights

Production		Increase
1997 Average Production	65 boepd	
1998 Average Production	537 boepd	> 8x
1997 Exit Production	450 boepd	
1998 Exit Production	1000 boepd	> 2x

Reserves		
1997 Proved Reserves	780 Mboe	
1998 Proved Reserves*	1992 Mboe	2.5x
1997 Total Proved + Probable	1130 Mboe	
1998 Total Proved + Probable*	2701 Mboe	2.4x

**Reserves after 1998 production of 195 Mboe*

Undeveloped Land Holdings		
1997 net land	19,388 acres	
1998 net land	103,612 acres	> 5x

Production

Principal Producing Areas

Area	Working Interest %	Gas (mcf/d)	NGLs (bpd)	Oil (bpd)	Equivalent (boepd)
Erskine, AB *	70	560	28	45	129
Joarcam, AB *	100	0	0	104	104
Ingoldsby, Sask *	54	0	0	73	73
Queensdale, Sask	25	0	0	66	66
Wapella, Sask *	100	0	0	55	55
Prevo, AB	9	340	12	8	54
Calling Lake, AB	28	440	0	0	44
Nipisi, AB *	36	0	2	41	43
Handsworth, Sask	20	0	0	40	40
Gainsborough, Sask	7	0	0	29	29
Minnehik, AB *	50	290	0	0	29
Rapdan West, Sask	23	0	0	23	23
Chip Lake, AB	62	210	1	0	22
Arcola, Sask	50	0	0	21	21
Brazeau, AB	1	180	1	0	19
Top 15 properties		2,020	44	505	751
Balance		1,380	15	98	251
Total		**3,400**	**59**	**603**	**1,002**

** BelAir operated*

In 1998, BelAir drilled 8.0 gross wells (5.15 net wells) resulting in 3.5 net oil wells, 1.05 net gas wells and 0.6 D & A wells, for a success ratio of 88%.

Reserves

[illegible] BelAir's petroleum and natural gas reserves have been evaluated as at January 1, 1999 by the independent [illegible] Fraser [illegible] Petroleum Consultants. The volumes presented in the following tables represent the Corporation's working interest in reserves before royalties.

Summary of Reserves Volumes as at January 1, 1999

Present Worth (in millions of dollars) Before Income Taxes, Escalated Prices

	Crude Oil Mbbl	NGLs Mbbl	Natural Gas MMcf	Mboe	Undiscounted	10%	15%	20%
Proved Producing	763	66	4,535	1,283	13.3	9.0	7.8	7.0
Proved Non-Producing	–	23	6,862	709	6.7	3.8	3.1	2.5
Total Proved	763	89	11,398	1,992	20.0	12.8	10.9	9.5
Probable	516	7	1,859	709	6.7	3.8	2.9	2.3
Total Proved + Probable	1,279	96	13,257	2,701	26.7	16.6	13.8	11.8

Comparative Reserves 1998 to 1997	Proven (Mboe)	Probable (Mboe)	Total
Reserves, January 1, 1998	780	350	1,130
Less: 1998 Production	(195)	–	(195)
Net Reserves Additions	1,407	359	1,766
Reserves, January 1, 1999	1,992	709	2,701

Undeveloped Land Holdings	Gross Acres	Net Acres
Alberta	163,613	72,245
British Columbia	5,732	1,062
Manitoba	4,740	990
Saskatchewan	37,475	29,315
	211,560	103,612

Management's Discussion and Analysis

The consolidated results of operations include the results of Granger Energy Corp. which was acquired effective November 1, 1998.

Revenue

Petroleum and natural gas sales for the year ended December 31,1998 were $3,670,290. These proceeds resulted from the sale of 898,730 mcf of natural gas, 79,950 barrels of oil and 26,242 barrels of natural gas liquids for an average of 537 per barrel of oil equivalent per day at an average price of $18.72 per barrel of oil equivalent.

Royalties

Royalty expense associated with these revenues amounted to $772,386 or $3.94 per barrel of oil equivalent.

Operating Expenses

Working interest operating costs were $1,314,331 or $6.70 per barrel of oil equivalent.

Other Income

Other income for the year amounted to $116,391 and was primarily earned by processing and transporting third party products.

BelAir Employees

Wayne Wilson
Vice President
Corporate Development

Lan Tran
Senior Accountant

Edina Wyborn
Reception

Vic Luhowy
President and
Chief Executive Officer

Ken MacRitchie
Vice President, Finance
Chief Financial Officer

Wendy Irvine
Executive Assistant

General and Administrative Expense

General and administrative expense for the year amounted to $810,636. Approximately 40% of this amount represented salaries and benefits, 15% was paid for professional services such as legal and audit, rent on office premises accounted for 10% of the total and another 10% for other third party consulting paid in connection with on going operations. The remainder is for insurance, statutory requirements of being a public company, office and computer services costs, bank fees and investor relations.

Interest

Interest expense for the year totaled $148,589 and was related primarily to interest paid on increased borrowing related to bank facilities used to fund capital requirements.

Depletion, Depreciation and Site Restoration

Consolidated depletion, depreciation and amortization expense for the year amounted to $3,886,262 after an adjustment for a ceiling test write-down of $2,500,000 on the net book value of oil and natural gas properties. The ceiling test was calculated using 1998 year end prices, for BelAir commodities, of $14.55 per barrel of crude oil, $11.96 per barrel for natural gas liquids and $2.21 per mcf for natural gas. The ceiling test writedown was primarily the result of low commodity prices rather than an impairment of reserves. The accounting guidelines which govern the calculation of the ceiling test allow only the inclusion of proven developed reserves. Further, it is a requirement that reserves be evaluated by using a "constant price" case for both revenues and operating costs. Probable reserves of 681,000 barrels of oil equivalent and the associated capital costs of development of $2 million have been excluded from the ceiling test calculation.

Provision for site restoration for the year was $73,344.

Income

The consolidated net loss of BelAir for the year ended December 31, 1998 amounted to $3,145,523 or $0.13 per weighted average share outstanding, after the ceiling test write-down.

Funds Flow from Operations

Consolidated cash flow for the year amounted to $740,739 or $0.03 per weighted average share outstanding.

Capital Expenditures and Additions

During the year, BelAir spent $11,678,666 on investing activities of which $6,918,185 was attributed to the acquisition of Granger Energy Corp. BelAir had net capital additions in the amount of $4,757,938 after property dispositions of $798,412.

Liquidity and Capital Resources

At December 31, 1998, BelAir had 46,977,153 common shares outstanding. Based on the last closing price in 1998 of $0.22 per share, market capitalization was $10.3 million. Working capital deficit at December 31, 1998, was $889,074. This amount includes a debenture outstanding in the amount of $175,000 due July 1, 1999. At year end, BelAir had drawn $3,669,036 on its $5,000,000 revolving credit facility with the National Bank of Canada. Bank credit facilities will be employed to finance capital investment activities that immediately generate cash flow. BelAir will continue to finance its short term requirements through internally generated cash flow. BelAir's 1999 capital program will be in excess of $3 million and will be financed by cash flow and bank financing.

Cash flow from operations was $740,739. This amount includes approximately two months of consolidated operating cash flow from the acquisition of Granger Energy Corp. During 1998, financing activities amounted to $9,259,843 including capital of $7,387,648 from the issuance of shares net of share issuance costs of $253,950 (3.5%).

On November 1, 1998, BelAir issued 21,928,732 common shares to satisfy the purchase of all the outstanding shares of Granger Energy Corp.

On December 31, 1998, a private placement financing was completed for gross proceeds of $597,500. BelAir issued 2,390,000 "flow through" common shares at a price of $0.25. Commission costs were $24,375 or 4% of the offering. Proceeds of the financing will be used to fund future oil and gas development activities.

In 1998, BelAir is committed to renounce $597,500 in Canadian exploration and deemed Canadian exploration expense to flow through shareholders.

Environmental and Safety Policy

BelAir has implemented a safety and environmental policy that is designed, at a minimum, to comply with current governmental regulations for the oil and gas industry. BelAir is committed to minimizing the effects of our activities on the environment and protecting our employees and contractors. BelAir implemented a corporate emergency response plan that adheres to government policies and regulations. The Corporation continually monitors government standards to ensure compliance with any changes to these policies and regulations.

An Environmental and Safety Committee has been established to report to the Board of Directors on a regular basis.

Business Risks

The oil and gas industry is subject to uncertainties and risks including commodity prices, product market demand, exploration success, transportation interruptions, foreign exchange and interest rates, government regulation and taxes and environmental and safety concerns.

BelAir minimizes these risks by diligent management of those factors that it can control. These factors are managed by the employment of highly qualified and experienced professionals, a strong and flexible financial position, proactive environmental and safety operating procedures and a focus on low cost reserve additions and cash flow optimization to sustain future growth. Extensive geological, geophysical, engineering, environmental and financial analysis are performed on the drilling of new prospects and potential acquisitions. BelAir can mitigate certain of these risks by operating in geographical areas characterized by low finding and development costs. Commodity price fluctuations can be offset by maintaining a balanced portfolio of oil and gas projects and production.

Year 2000 Issue

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. Problems could arise in BelAir's internal systems, in systems used by contractors and suppliers as well as more widespread issues involving pipelines, transportation systems, communications, banks, government operations other services which would impact on the Corporation's ability to carry on its business. The Corporation's potential exposure results from problems it can control and those it cannot.

BelAir is addressing the Year 2000 issue, as follows, by:

1. Identifying and assessing all critical equipment, software systems, facilities and business relationships.
2. Testing critical items as well as contingency planning.
3. Implementing procedures to remedy problems identified and to maintain Year 2000 readiness.

BelAir has implemented remedial solutions in all areas under its control. BelAir's internal operations are dependent on computer systems with respect to financial reporting, the evaluation of exploration and development opportunities and communication. BelAir owns computer equipment and software that has been purchased recently. The suppliers of the equipment and software have confirmed that the equipment and software is Year 2000 ready. During 1999, the BelAir will continue to request confirmation from key suppliers that it will not be exposed to Year 2000 related risks. BelAir has and continues to back up all of its financial and business records, property, geophysical and engineering data to ensure that no loss of information will occur. Notwithstanding these initiatives, there is no assurance that systems of customers, suppliers and other third parties will be Year 2000 compliant. BelAir expects that any failure to take remedial action by third parties would not have an adverse material effect on the Corporation. Costs related to Year 2000 readiness are not expected to be material to the Corporation and are expensed as incurred.

Management's Report

The accompanying financial statements and all information in the Annual Report are the responsibility of management. The financial statements have been prepared by management in accordance with the accounting principles generally accepted in Canada as outlined in the notes to the financial statements. Financial statements include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements have been prepared within acceptable limits of materiality. Financial information presented throughout the Annual Report has been prepared and reviewed by management to ensure it is consistent with that shown in the financial statements.

Management is responsible for the integrity of the financial statements. Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements, principally through the Audit Committee.

The Audit Committee is appointed by the Board of Directors and is comprised of a majority of independent directors which are not employees of the Company. The Audit Committee meets regularly with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is discharging its responsibilities and to review the financial statements and the external auditor's report.

KPMG, an independent firm of Chartered Accountants, has been engaged, as approved by a vote of the shareholders, to audit the financial statements in accordance with generally accepted accounting standards in Canada and provide an independent professional opinion on the financial statements. Their examination includes a review and evaluation of the Company's system of internal control and such tests and procedures as considered necessary to provide reasonable assurance that the financial statements are presented fairly.

The financial statements including the notes have been approved by the Board of Directors on the recommendation of the Audit Committee.

Victor M. Luhowy
President and CEO

Kenneth D. MacRitchie
Vice President, Finance and CFO

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of BelAir Energy Corporation as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 18, 1999

Consolidated Balance Sheets

December 31, 1998 and 1997

	1998	1997
Assets		
Current assets:		
Cash	$ –	$ 275,819
Short-term deposits	–	800,000
Accounts receivable	1,760,033	716,351
Prepaid expenses	105,128	167,047
Current portion of notes receivable (note 3)	17,986	17,109
	1,883,147	1,976,326
Notes receivable (note 3)	18,905	36,891
Capital assets (note 4)	14,247,328	6,316,935
	$ 16,149,380	$ 8,330,152
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 2,597,221	$ 1,365,736
Debenture payable (note 6)	175,000	300,000
	2,772,221	1,665,736
Bank loan (note 5)	3,669,036	410,000
Debenture payable (note 6)	–	175,000
Provision for future site restoration	351,195	41,663
Shareholders' equity (note 7):		
Share capital	12,554,978	3,908,982
Share capital to be issued	–	156,298
Special Warrants	–	2,025,000
Deficit	(3,198,050)	(52,527)
	9,356,928	6,037,753
Commitments (note 9)		
	$ 16,149,380	$ 8,330,152

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Victor Lukkov

Director

Director

Consolidated Statements of Operations and Deficit

Years ended December 31, 1998 and 1997

	1998	1997
Revenue:		
Petroleum and natural gas sales	$ 3,670,290	$ 480,316
Royalties	(772,386)	(85,345)
Other	116,391	7,285
	3,014,295	402,256
Expenses:		
Operating	1,314,331	107,365
General and administration	810,636	174,794
Interest on longterm debt	148,589	14,028
Depletion, depreciation and amortization (note 4)	3,886,262	158,596
	6,159,818	454,783
Net loss	(3,145,523)	(52,527)
Deficit, beginning of year	(52,527)	–
Deficit, end of year	$ (3,198,050)	$ (52,527)
Per share amounts:		
[illegible] diluted	$ (0.13)	$ (0.01)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1998 and 1997

	1998	1997
Cash provided by (used in):		
Operations:		
Net loss	$ (3,145,523)	$ (52,527)
Item not involving cash:		
Depletion, depreciation and amortization	3,886,262	158,596
Funds flow from operations	740,739	106,069
Change in non-cash operating working capital	602,265	(453,066)
	1,343,004	(346,997)
Financing:		
Issue of share capital	7,387,648	4,265,013
Share issue costs	(253,950)	(356,031)
Bank loan	2,409,036	410,000
Debenture payable	(300,000)	175,000
Note receivable	17,109	(54,000)
Issue of Special Warrants	–	2,025,000
Share capital to be issued	–	156,298
	9,259,843	6,621,280
Investments:		
Business acquisitions (note 2)	(6,918,185)	(2,337,311)
Exploration and development	(5,556,350)	(2,861,153)
Proceeds on sale of petroleum and natural gas properties	798,412	–
Site restoration expenditures	(2,543)	–
	(11,678,666)	(5,198,464)
Net increase (decrease) in cash	(1,075,819)	1,075,819
Cash, beginning of year	1,075,819	–
Cash, end of year	$	$ 1,075,819

Cash is comprised of cash and short-term deposits.

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 1998 and 1997

Incorporation and basis of presentation:

BelAir Energy Corporation ("BelAir" or "the Corporation") was formed on October 31, 1997 pursuant to an amalgamation agreement between Gold Butte Energy Inc. ("Gold Butte") and Holdco Resources Ltd. ("Holdco") dated August 29, 1997.

Gold Butte was incorporated as 709197 Alberta Ltd. under the Business Corporations Act (Alberta) on September 12, 1996. On October 31, 1996, a Certificate of Amendment was received from the Alberta Government which approved the name change to Gold Butte. Gold Butte commenced operations on May 28, 1997. Holdco was incorporated as 709199 Alberta Ltd. under the Business Corporations Act (Alberta) on September 12, 1996. 709199 Alberta Ltd. changed its name to Holdco on February 26, 1997. Holdco commenced operations on July 1, 1997. The predecessor corporation's being Holdco and Gold Butte, were inactive from the date of incorporation to December 31, 1996.

These financial statements include the accounts of the Corporation for the year ended December 31, 1998 and its wholly-owned subsidiary, Impala Energy Inc. ("Impala") for the period from November 1, 1998 to December 31, 1998 (see note 2).

1. Significant accounting policies:

(a) Capital assets:

The Corporation follows the full cost method of accounting for oil and gas operations, whereby all costs of exploring for and developing oil and gas properties and related reserves are capitalized. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, and geological and geophysical expenses and related overhead.

Capitalized costs, excluding costs relating to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of oil and gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative sales value.

The Corporation applies a "ceiling test" to capitalized costs to ensure that the net costs capitalized do not exceed the estimated future net revenues from the production of its proven reserves, plus the cost of undeveloped lands, less impairment. Future net revenues are calculated at year end prices and include an allowance for estimated future general and administrative expenses, interest expense, income taxes, and capital expenditures.

Gains or losses on the disposition of oil and gas properties are not ordinarily recognized except under circumstances which result in a change in the depletion rate of 20% or more.

Depreciation of furniture and office equipment is provided using the straight-line method based upon estimated useful lives at rates of 10% to 35%.

(b) Interest in joint ventures:

Substantially all of the Corporation's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Corporation's proportionate interest in such activities.

(c) Future site restoration and abandonment costs:

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Corporation's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

(d) Measurement uncertainty:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(e) Per share amounts:

Per share amounts are calculated using the weighted average number of shares outstanding during the year. Fully diluted per share calculations reflect the exercise of options and warrants at the later of the date of issuance or the beginning of the year. Anti-dilutive options and warrants are not included in the calculation.

(f) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

(g) Deferred income taxes:

The Corporation follows the deferral method of tax allocation accounting under which the provision for corporate income taxes is based on the earnings (loss) reported in the accounts and takes into account the tax effects of timing differences between financial statement income (loss) and taxable income.

2. Business acquisitions:

(a) Effective November 1, 1998, under a plan of arrangement, the Corporation, through its wholly-owned subsidiary, Impala, acquired all of the issued and outstanding shares of Granger Energy Corp. The acquisition was accounted for using the purchase method with the results of operations being included from the date of acquisition.

Allocated:	
Capital assets	$ 7,654,372
Current assets	379,306
Current liabilities	(26,763)
Provision for site restoration	(238,730)
Long-term debt	(850,000)
	$ 6,918,185
Cost of acquisition:	
Share capital issued	$ 6,758,620
Cash paid to dissenting shareholder	159,565
	$ 6,918,185

(b) Effective December 18, 1997, the Corporation acquired all of the issued and outstanding Common Shares of Windstar Energy Ltd. The acquisition was accounted for using the purchase method with the results of operations being included from the date of acquisition:

Allocated:	
Capital assets	$ 3,604,000
Current assets	441,661
Current liabilities	(1,677,065)
Provision for site restoration	(31,285)
	$ 2,337,311
Cost of acquisition:	
Share capital issued	$ 2,181,013
Shares issued in 1998	156,298
	$ 2,337,311

(c) On October 29, 1997 at a special meeting of the holders of Common Shares of Gold Butte and Holdco, approval was received for the Amalgamation of Gold Butte and Holdco. Under the terms of the Amalgamation Agreement the Common Shareholders of each of Gold Butte and Holdco received one Common Share of BelAir for each Common Share of Gold Butte and Holdco held. The nature of the transaction was such that no acquirer could be identified, therefore the amalgamation has been accounted for as a pooling of interests whereby the financial statements of BelAir reflect the combined historical carrying values of the assets, liabilities, and shareholders equity, and the historical operating results of Gold Butte and Holdco for the period ended October 31, 1997.

The assets and liabilities, at book values, at the date of the business combination are as follows:

	Gold Butte	Holdco
Assets	$ 394,265	$ 1,442,267
Liabilities	(17,100)	(733,623)
Net assets	$ 377,165	$ 708,644

The revenues and losses of Gold Butte and Holdco for the period from January 1, 1997 to October 31, 1997 were as follows:

	Gold Butte	Holdco
Revenues	$ 4,165	$ 228,888
Net loss	25,747	10,356

3. Notes receivable:

The notes receivable are due from officers and directors of the Corporation. Interest on the notes is calculated monthly at 5% per annum in arrears commencing January 15, 1998. The notes are repayable in blended installments aggregating $808 payable twice monthly until January 31, 2001. The notes are secured by an assignment of 60,000 Common Shares of the Corporation which are releasable to the borrower as principal payments are made, provided that, at the time of the release, the value of the remaining security is at least 1.25 times the principal amount outstanding.

4. Capital assets:

1998	Cost	Accumulated depletion, depreciation and amortization	Net book value
Petroleum and natural gas properties and equipment	$ 17,884,380	$ 3,927,300	$ 13,957,080
Furniture and office equipment	324,083	33,835	290,248
	$ 18,208,463	$ 3,961,135	$ 14,247,328

1997			
Petroleum and natural gas properties and equipment	$ 6,400,082	$ 146,644	$ 6,253,438
Furniture and office equipment	65,071	1,574	63,497
	$ 6,465,153	$ 148,218	$ 6,316,935

As a result of a ceiling test calculation as at December 31, 1998, it was determined that the net book value of the Corporation's petroleum and natural gas properties exceeded the net recoverable amount calculated under the full cost accounting guideline and a write-down of $2,500,000 was recorded as additional depletion. The year-end ceiling test was computed using December prices of $14.55/bbl for crude oil and $2.21/mcf for natural gas.

The costs of unproven lands at December 31, 1998 of $3,800,000 (1997 - $1,195,000) has been excluded from the depletion calculation.

As at December 31, 1998 the estimated future site restoration costs to be accrued over the remaining proved reserves are $1,366,000 (1997 - $203,000) of which $73,345 (1997 - $41,663) is included in depletion and depreciation in the current year.

5. Bank loans:

The Corporation has available the following loan credit facilities with a chartered bank:

Revolving demand loan to a maximum of $5,000,000, bearing an interest rate of prime plus 3/4%	$ 3,669,036
Non-revolving demand acquisition loan to assist in financing oil and gas property acquisitions to a maximum of $4,000,000, bearing interest at prime plus 1%	–
Treasury/swap risk line, for the purchase of various interest rate, foreign exchange and energy commodity swaps and forwards to a maximum amount of $2,500,000 and a maximum term of 48 months to be settled by the terms of the contract	–
	$ 3,669,036

The loans are secured by a general assignment of book debts and $20,000,000 first fixed and floating charge debenture on all assets. The Corporation is required to meet certain financial and engineering reporting requirements. The loans are subject to an annual review. The next annual review will be undertaken before April 30, 1999. Though the loans are of the demand nature, the bank does not foresee calling the loans within the current fiscal year therefore these loans have been classified as long-term.

6. Debentures payable:

A subordinated debenture in the amount of $175,000 due July 1, 1999 was issued to the vendor of certain oil and gas properties. Interest is payable semi-annually beginning January 1, 1997 at a rate of 6% per annum. The debenture may be repaid at any time prior to maturity at the Corporation's option. At maturity, the

repayment amount will be calculated using a straight line formula with $175,000 being repaid if the trading value of the shares of the Corporation for the 10 days previous to repayment is equal to or greater than $0.40. The debenture amount repayable is $75,000 if the average trading value of the Corporation's shares in the 10 days prior to repayment equals $0.25 or less. A straight line sliding scale formula is in place to calculate the amount repayable if the average trading value of the Corporation's shares for the ten days prior to repayment is between $0.25 and $0.40. The debenture payable is secured by a general security agreement covering all present and future assets of the Corporation.

7. Capital stock:

(a) Authorized:

Unlimited number of voting Common Shares

Unlimited number of non-voting First Preferred Shares, issuable in series

(b) Common shares issued:

	Number of Shares	Amount
Initial private capital	4,000,000	$ 384,000
Private placement	1,000,000	250,000
Private placement for oil and gas properties	1,000,000	250,000
Public offering	1,500,000	300,000
Private placement	2,000,000	900,000
Issued on business acquisition (note 2)	7,976,966	2,181,013
Share issuance costs	–	(356,031)
December 31, 1997	17,476,966	3,908,982
Common Shares issued on exercise of Special Warrants (iv)	2,250,000	1,012,500
Flow-through shares issued on exercise of Special Warrants (iv)	2,250,000	1,012,500
Issued on business acquisition in 1997(note 2(b))	571,655	156,298
Issued on business acquisition (note 2(a))	21,928,732	6,758,620
Issued on consideration of services	59,800	21,528
Flow-through shares issued	2,390,000	597,500
Exercise of stock options	50,000	10,000
Tax effect of flow-through shares	–	(669,000)
Share issuance costs	–	(253,950)
Balance, December 31, 1998	46,977,153	$12,554,978

(i) Of the Common Shares issued to date 4,170,000 are held in escrow and may not be released from escrow and traded without the written consent of the Executive Director of the Alberta Securities Commission, subject to any earlier automatic releases that may be permitted under a policy adopted by the Alberta Securities Commission.

(ii) The Corporation has established a Stock Option Plan for the benefit of directors, officers, key employees and consultants of the Corporation. Pursuant to the Stock Option Plan, options for a total of 3,050,000 Common Shares have been granted to the directors and officers of the Corporation. These options may be exercised at prices of $0.20 to $0.40 per share at various dates until 2003. A further 172,000 options have been issued to employees and consultants of the Corporation at an exercise price ranging from $0.20 to $0.58 per share expiring at various dates until 2003.

(iii) The Corporation has reserved an aggregate of 150,000 Common Shares pursuant to an option granted under an agency agreement dated March 27, 1997. Such option may be exercised at a price of $0.20 per share until January 2, 1999. On December 31, 1998, 50,000 options were exercised and the balance of the options have expired January 3, 1999.

(iv) Special Warrants:

On November 24, 1997, the Corporation issued 2,250,000 Special Warrants at $0.90 each for gross proceeds of $2,025,000 on a private placement basis. Each Special Warrant entitled the holder to receive upon exercise or deemed exercise and without payment of any additional consideration, one Common Share and one flow-through Common Share of the Corporation. These warrants were exercised on March 19, 1998.

(v) Warrants:

On December 18, 1997 in conjunction with a private placement the Corporation issued 1,000,000 Common Share purchase warrants exercisable at any time until December 18, 1999 on the basis of one warrant plus $0.70 for each Common share.

In conjunction with the acquisition of Windstar, the Corporation issued 857,160 Common Share purchase warrants in exchange for previously issued Windstar Common Share purchase warrants. Each Common Share purchase warrant is exercisable on the basis of one warrant plus $0.67 for each Common Share any time until September 24, 1999.

BelAir Energy Corporation
420 First Alberta Place
777 Eighth Avenue S.W.
Calgary, Alberta T2P 3R5